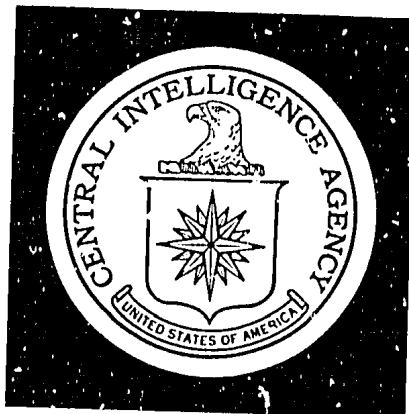


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OFFICE OF
NATIONAL ESTIMATES

MEMORANDUM

Israel: Coping with "Peace" and "Prosperity"

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26 January 1972

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CENTRAL INTELLIGENCE AGENCY

OFFICE OF NATIONAL ESTIMATES

26 January 1972

MEMORANDUM

SUBJECT: Israel: Coping with "Peace" and "Prosperity"*

In its less than 25 years of history, Israel has survived numerous crises and traumas and thrived. Its people, individually and collectively, have overcome obstacles to their nationhood and created a country that is frequently pointed out as an outstanding social and economic success. Its political institutions were born of adversity and they served a struggling new country well. But the existing political mechanism may not be able to cope so successfully with the twin challenges it now faces -- "peace" and "prosperity". Over time, these seemingly favorable circumstances may produce problems more intractable, within the Israeli system, than the Arab-Israeli issues that loom so large

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The potential difficulties look at first glance to be economic in nature, but they would arise from political and social causes.

The Key Role of Labor

1. Organized labor and politics are inextricably intertwined in Israel. In one guise or another, the union member is the basic source of political and economic power in the

* This memorandum was prepared by the Office of National Estimates and discussed with other components of the CIA, who are in general agreement with its judgments.

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country. It is a moot point whether the Labor Party controls the Histadrut (federation of labor) or vice versa. The Histadrut began as a voluntary association through which Jewish labor activists in Palestine pooled their meager resources to provide social and economic services to the Jewish community. It established schools, hospitals, and even an army. Since the establishment of the state, it has more and more become concerned with economic interests -- that is, with benefits for the workers. In short, it has come to more nearly resemble a labor union. Although it has been shorn of many of its original quasi-governmental activities, it has become the country's largest single employer, by virtue of its ownership of industrial establishments.

2. Union membership is prerequisite to membership in the Israel Labor Party -- a 1968 coalescence of various elements that split from a single labor party of the 1930s or from one of its assorted descendents. Its core -- called MAPAI until the latest merger -- has remained intact throughout the pre-history and history of the state and has dominated the major governing bodies of Jewish Palestine throughout its existence. In the six Knesset (parliament) elections that have been held, MAPAI has always had a large plurality of the vote -- but never a majority. Voting

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patterns have been remarkably stable; the labor groups as a whole have always received 48 to 51 percent of the popular vote; the leader of the MAPAI grouping has always been the Prime Minister.

3. Jointly, by agreements normally worked out between the Labor Party leaders of the government and the Labor Party leaders of the Histadrut, party and union formulate the Cabinet position on all issues of urgent concern to the worker. Individuals reach key positions in this combine by remaining loyal to its agreed policy at all times, since one cannot be elected to national or union office until he has been appointed to the slate of candidates by the Labor Party leadership. Under the laws passed by the Labor Party-dominated Knessets, virtually all financial transactions -- wages, interest rates, wholesale and retail prices, rents -- are linked together by cost-of-living escalator clauses, and the escalator is almost always going up, speeded by expansionary monetary and fiscal policies.

Lean Years

4. The inflationary nature of the institutional arrangement is obvious, but its impact has been somewhat restrained in the past by philosophical convictions, as well as by the realities

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of limited resources. Mrs. Meir and the group that lead Israel are notable for their longevity and firmness of convictions; they have governed the Jewish inhabitants of Palestine for decades according to a set of fundamental assumptions that were shared unquestioningly by the bulk of the population. Belief in the existence of an active Arab military threat to the state and in the willingness, indeed the eagerness, of all Israelis to make great personal sacrifices for the common good served to restrain demands for personal benefits and channel resources into the country's agricultural and industrial base and into a strong military establishment. Foreign sources provided generous aid, but even so the balance of payments situation was constantly precarious.

5. The spirit of self-sacrifice remained strong at least until the early 1960s. In its early years, Israel was composed of the pioneers of the pre-World War II era who had come with high ideals and created a country out of nothing, refugees from persecution who were grateful for escape and willing to wait for material benefits, and a relatively small number of immigrants from prosperous circumstances in the West. They fought the desert and they fought the Arabs, and they built one of the most egalitarian societies in the modern world. However, they became

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in a sense victims of their own success. By 1964, the combination of rising living standards and dwindling Arab threat led to a slackening of the inflow of foreign funds. This circumstance coincided with domestic inflation that made exports less competitive. Immigration -- an important source of new workers, new money, and new demands for housing and goods -- dropped off, partly in response to the developing recession. Balance of payments pressures brought on a government austerity program. Israel found itself in a serious recession that persisted until the 1967 war.

And Fat Ones

6. The short war was followed by new prosperity. Contributions from abroad swelled, immigration picked up, and Israel's determination to build a major defense industrial establishment provided a new source of demand for both workers and products. A boom ensued that raised per capita real incomes more than 20 percent in four years, while population was growing about 12 percent. Unemployment of Israelis is minimal, and about 45,000 Arabs from the occupied areas work in Israel. The government has had rapidly growing amounts of money to allocate -- both from increased domestic production and from even more

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rapidly increasing massive foreign gifts and loans -- and has channeled most of the increment into defense and into investment. Personal consumption has risen, but not as fast. (See Table I.) The public accepted the government's statements that vast defense expenditures were necessary to counter the Arab threat, and various measures to restrain the growth of personal consumption passed the Knesset with relative ease and were imposed on the citizenry with comparatively little complaint and no massive attempt at evasion until recently.

7. In the past two years, however,

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many Israelis are less disposed to sacrifice immediate economic gains in the interests of problematical future improvements. They have become so inured to hollow Arab military threats -- and so accustomed to expecting foreign sources to help finance necessary military measures -- that they are much less receptive to exhortations about the need to delay internal programs in the interests of military preparedness. Austerity and the struggle for survival have been replaced by prosperity and the struggle for individual shares in a boom country. One or another union has been out on strike without Histadrut approval almost constantly. Employers, faced with rising demands for goods and a paucity of workers, have offered under-the-table benefits beyond the legal

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maximums, and various other ways of evading price and wage controls have become common. Prices rose more than 10 percent in 1970 and over 13 percent in 1971; wages rose about 15 percent in 1971, and increases in excess of 10 percent are expected in early 1972.

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8. Meanwhile, conspicuous consumption has appeared on the Israeli scene. The disparity between rich and poor in Israel is more keenly felt, and it has been fueling increasing animosities between various social groups. The cultural, social, and educational divisions between Israelis of European origin and those from Eastern (largely Arab) countries that had become troublesome in the mid-1960s disappeared from sight and discussion during and immediately after the 1967 war, but they have re-emerged with emphasis on the economic grievances of the Eastern youths. Special benefits offered to attract immigrants and make them want to remain appear to the Easterners to be aimed largely at Westerners in general and recent arrivals from the USSR in particular. Easterners who were born in Israel or have been there for years and have had poor housing and low incomes throughout that time resent both the financial discrimination and the apparent "racial" basis

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for it. Their resentment has been publicly voiced of late by the self-proclaimed Black Panthers, who have taken to public, occasionally somewhat violent, demonstrations to publicize their grievances.

9. Another large segment of the population deeply resents being forced by religiously imposed law -- or lack of law -- to pretend to religious convictions it does not hold. In the past couple of years, heated disputes -- growing, for example, from the absence of civil marriage or divorce and the denial of certain civil rights to children whose parents have failed to conform in some way to religious law -- have attracted wide publicity and attention. The Labor Party leadership, depending as it always has on an alliance with the National Religious Party for an absolute majority in Knesset, has refused to permit relevant legislation to be considered, leaving each individual case to be compromised somehow in out-of-court settlements that typically are reached at the last possible moment before the courts would be forced to make judgments that might set undesirable precedents.

10. The kinds of problems outlined above are not new; they have erupted in passionate disputation from time to time throughout Israeli history. In the past, however, their divisive impact

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on society has been minimized by the felt need for national solidarity to counter danger from the surrounding and hostile Arabs. In the event of a renewed feeling of threat from the Arabs, intramural quarrels would disappear in a trice. At present, however, there is very little concern that the Arabs will launch a major attack on Israel and even less worry that such an attack would do serious damage. The Israeli public is continually reassured by its leaders that it is militarily stronger in relation to its neighbors than ever before in its history; it *feels* more secure and safe than ever. Paradoxically, this feeling is reflected in an argument that *is* unique -- a debate over the size of the defense budget.

Guns or Butter

11. Israeli military spending has rocketed since the 1967 war. The military establishment has swollen, it has acquired new armaments, and it has adopted some of the habits of large professional armies elsewhere.* At the time of the 1967 war,

* *Some examples: The Israeli Defense Forces have begun awarding medals and campaign ribbons; soldiers are being forced to get haircuts; the military is developing a special toothbrush and toothpaste for soldiers; a computerized supply system has been introduced.*

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Israel had a 55,000-man standing army equipped with about 1,100 tanks and about 250 fighter aircraft. It fought the Arabs and won handily.

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12. Domestic defense expenditures have also doubled and redoubled; more personnel have received higher pay and greater fringe benefits, fortifications such as the Bar-Lev line have been costly, and purchases of domestically produced defense goods have gone up markedly. The defense budget totaled \$400 million in the last pre-war year (one-quarter of the total budget); it will come to about \$1.6 billion (half of the total) in the 12 months ending in March 1972. The original proposal for the fiscal year ending in March 1973 came to \$1.6 billion, but Defense Minister Dayan pared it to \$1.4 billion before submission to the Cabinet. A number of Israelis are beginning to question the need for such outlays to protect Israel's new, more

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defensible cease-fire lines against enemies without any perceptible aggressive capability.

13. The availability of foreign financing has contributed to the growth of military expenditures. Obviously, current defense -- especially during the active war of attrition -- and future preparedness required new and better arms, and fear of a future cutoff of foreign supplies would have spurred the development of local manufacturing capability even if diversion of funds from civilian to military pursuits had been necessary.

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14. The Israeli defense establishment, in drawing up its requirements, is trying to provide for all contingencies. The economic advisor to the Minister of Defense commented a few weeks ago that no military activities could be reduced in size or cost without risk to Israel's security, since any budget cuts reduce the military options, and any reduction of options entails increased risks. At about the same time, a commentator writing in Israel's major newspaper on the defense expenditure question pointed out that the government has failed to make any choices among possible alternative policies on defense and/or settlement. He urged the government to decide where it wants to go on these related issues so that the budget actions could reflect agreed priorities.

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15. Over the long run, the most significant facet of the budget debate is the new attitude that has been revealed. In the past, when many Israelis were poor, most lived modestly, and very few were rich, the military budget was scarcely debated and never cut substantially. Now, however, Israelis are arguing that defense is no longer a sacrosanct area -- it should have to compete for funds with other goals, such as housing and education, as well as private consumption.

Spend Now, Worry Later

16. Israel's citizens do not, at present, perceive any pressing need for individual economic restraint. They feel more secure from Arab attack than in the past and do not, in any case, believe that the availability of military hardware is dependent on Israeli ability to pay for what is necessary. In the face of a \$260 million increase (63 percent) in foreign exchange reserves over the past two years, dire warnings from the Finance Ministry and the Bank of Israel of future foreign currency imbalances sound hollow indeed. The threats Israelis do see -- future inflation, further currency devaluation, and possible loss of economic position relative to Israelis in other social groups -- are personal, and getting as much as possible for himself

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as quickly as possible looks to the individual to be the best defense.

17. Reconciling public demands with Israeli resources probably is no longer possible; in any event it would require a major change in the outlook of the government leaders. The leadership, however, is notable both for longevity and for firmness of conviction; the same people have led, according to the same notions, for 30 years or more.

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Israel's leaders know Israel's

resources are inadequate to meet rising demands, but they are not prepared for the political consequences of a rigidly enforced austerity program. Chances are that Mrs. Meir and others of her background do not recognize a basic problem: that some of the premises on which they founded and built the state are no longer accepted by the majority of their fellow citizens. Without consensus on such premises as the need for sacrifice to build and defend the society, the machinery of the state cannot deal with certain problems.

18. While the government ponders Israel's problems, social strains are likely to get worse. The government can do little to

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alleviate the religious (orthodox/nonobservant) controversy without risking a parliamentary crisis. The leadership is so thoroughly European in outlook that drastic action aimed at quickly eliminating the causes of Eastern grievances is virtually inconceivable. The growing affluence of one segment of society is attributable largely to booming prosperity. The palliative for these social strains -- greatly increased welfare measures -- would exacerbate inflationary pressures, add to the strains on the balance of payments, and increase the need for foreign financial assistance.

19. If a crisis arises from the pressures for higher and higher wages and more and more social services, it is far more likely to be an economic crisis than a political one. The political system does not contain any mechanism whereby the government can resist the demands of the union; it can only try to persuade and cajole. The Histadrut, for its part, has nothing to gain by bringing down the government even if it could, since no other government would be more responsive to its demands. Reducing defense outlays can free some funds for other purposes, but no Israeli leader is going to permit significant weakening of Israel's defense establishment. The defense budget is, therefore, likely to remain very large for the foreseeable future. For

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some period, demands for both guns and butter can be met by seeking more loans and grants from abroad; the durability of this solution depends on the size of inflows of foreign funds. An unmanageable situation will arise only when expenditures have exceeded income -- earnings, gifts, and loans -- for enough time and by a large enough amount so that foreign exchange reserves drop alarmingly. Then and only then will the government be able to convince the people that economic restraints are essential to national security.

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TABLE I

EXPENDITURES AS A PERCENTAGE OF GROSS NATIONAL PRODUCT

	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>6 Months 1971</u>
Public Consumption	23.0	31.0	31.5	31.6	36.8	36.4
Of which: Defense	10.0	16.4	17.9	20.4	26.0	N.A.
Private Consumption	67.9	67.2	66.4	67.5	63.3	61.8
Investment	<u>24.6</u>	<u>18.2</u>	<u>23.5</u>	<u>24.2</u>	<u>25.4</u>	<u>28.6</u>
TOTAL	115.6	116.4	121.4	123.2	125.5	126.8

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TABLE II

ISRAEL: MAJOR SOURCES OF INCOME FROM ABROAD
(Million Dollars)

	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971^{a/}</u>	<u>1972^{a/}</u>
Earnings (Exports of Goods and Services)	832	908	1,147	1,228	1,386	1,635	1,890
Transfers - Total ^{b/}	295	539	448	474	676	760	620
Of which: Institutions (Largely United Jewish Appeal)	105	322	163	172	257	300	250
Government Long-Term Borrowing - Total	241	386	379	318	736	850	1,050
Of which: Israeli Bonds (Largely US)	124	232	182	184	231	251	220
US Government	39	40	52	94	374	390	750 ^{c/}

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